

IT 00-4

Tax Type: Income Tax

Issue: Reasonable Cause on Application of Penalties

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS

v.

“BHC CORPORATION”,

Taxpayer

No. 97-IT-0000
FEIN: 95-0000000

Christine O’Donoghue
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Ms. Diane Anderson of Neal Gerber & for “BHC Corporation”; Mr. Rickey Walton, Special Assistant Attorney General for the Illinois Department of Revenue.

Synopsis:

This cause comes on for hearing pursuant to “BHC Corporation’s” (“taxpayer”) protest of the Notice of Deficiency (“NOD”) issued by the Department of Revenue (“Department”) on July 10, 1997. The NOD was issued to the taxpayer for failure to file Quarterly Illinois Withholding Tax Returns (“IL-941s”) for the period that included the fourth quarter of 1994 and the first, second and third quarters of 1995 (“audit period”). At issue is whether the Department correctly imposed and calculated the non-filing penalty pursuant to Section 3-3(a) of the Uniform Penalty and Interest Act (“UPIA”), 35 ILCS 735/3-1 *et seq.* Following a period of discovery, the parties filed cross-motions for

summary judgment. After reviewing the parties' motions, the exhibits attached thereto, and memoranda filed in support of the motions, it is my recommendation that summary judgment be entered for the taxpayer and the Department's motion for summary judgment be denied.

Facts Not in Dispute:

1. During the period in question, taxpayer was required to make quarter monthly payments of withholding taxes.
2. Taxpayer timely paid all of the tax which it had withheld from its employees for the first, second and third quarters of 1995. The taxpayer did not timely pay all of the tax that it had withheld for the fourth quarter of 1994. (Dept. & Taxpayer's Motion for Summary Judgment)
3. Taxpayer did not have a tax liability as of the due date of its IL-941 tax returns for the first through third quarters of 1995. (Dept. & Taxpayer's Motion for Summary Judgment)
4. The tax underpayment for the fourth quarter of 1994 was \$6,923.10 (\$209,276.00 (as stated on the taxpayer's IL-W-3 for 1994) minus \$202,352.90 (total payments made). Dept. Ex. No. 1; Dept.'s Response to Taxpayer's First Set of Interrogatories, No. 4, Ex. 6.

Conclusions of Law:

A motion for summary judgment is appropriate where the pleadings, affidavits, and other documents on file show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. 735 ILCS 5/2-1005(c); People ex rel. Department of Revenue v. National Liquors Empire, Inc., 157 Ill.

App. 3d 434 (4th Dist. 1987). Summary judgment is also appropriate when the parties agree on the facts, but dispute the correct construction of the applicable statute. Bezan v. Chrysler Motors Corp., 263 Ill. App. 3d 858, 864 (2nd Dist. 1994). In this case, the parties agree that there is no genuine issue of material fact, thus, an action for summary judgment is appropriate.

The issues for hearing as outlined in the pre-trial order are the following:

1. Did the Taxpayer timely file quarterly returns (Form IL-941) for the four quarters in issue?
2. If the returns were not timely filed, did the Department properly calculate the late filing penalty pursuant to Section 3-3 of the Uniform Penalty and Interest Act (“UPIA”), which is incorporated by reference in Section 1001 of the Illinois Income Tax Act?
3. (a) Is the Department’s interpretation of UPIA Section 3-3 a ‘rule’ within the meaning of Section 1-70 of the Illinois Administrative Procedure Act (“APA”)? (b) If so, does the Department’s failure to formally adopt that position as a “regulation” or “rule” before applying it to taxpayer violate (i) the rulemaking requirements of the APA, (ii) Section 3 of the Illinois Department of Revenue Sunshine Act, or (iii) the Due Process Clause of the Illinois or U.S. Constitutions? (c) If the assessment is cancelled, is taxpayer entitled to attorneys’ fees and other costs pursuant to APA Section 10-55(c)?
4. Does UPIA Section 3-3(a), as amended by Public Act 89-379, require the abatement of the late filing penalty for the fourth quarter of 1994?
5. If the returns were not timely filed, should the late filing penalties be abated for reasonable cause?

It must first be determined whether the taxpayer timely filed the tax returns for the four quarters at issue, and if not, a determination should be made as to whether the late-filing penalties should be abated due to reasonable cause. Although the taxpayer argues that it filed withholding tax returns (“IL-941s”) for the fourth quarter of 1994 and the first, second and third quarters of 1995 (“audit period”), the record does not support its contention. Taxpayer does not have any proof of mailing for the returns at issue and

merely asserts that it “believes that the ...quarterly returns were originally filed when due.” Taxpayer’s Brief, p. 3. Further, it cannot produce copies of the original IL-941s that it believes were timely filed. Taxpayer Brief p. 3. Taxpayer’s mere assertions without corroborating documentary evidence does rebut the *prima facie* correctness of the Department’s Notice of Deficiency, (35 ILCS 5/904(a); Balla v. Department of Revenue, 96 Ill. App. 3d 293 (1st Dist. 1981)), thus, I cannot find that the returns at issue were timely filed.

Secondly, it must be determined whether the late-filing penalties under UPIA Section 3-3(a) should be abated due to reasonable cause. The Department argues that reasonable cause for failing to file IL-941s for the audit period has not been demonstrated because the taxpayer did not implement a system to track whether its withholding returns were actually filed.

Section 3-8 of the UPIA provides as follows:

§ 3-8. No penalties if reasonable cause exists. The penalties imposed under the provisions of Sections 3-3, 3-4, and 3-5 of this Act shall not apply if the taxpayer shows that his failure to file a return or pay tax at the required time was due to reasonable cause. ...

35 ILCS 735/3-8.

Section 700.400 of the Department’s regulations provides that reasonable cause is to be determined on a case by case basis taking into account all of the facts and circumstances. 86 Ill. Admin. Code Sec. 700.400(b). The regulation further provides that:

“A taxpayer will be considered to have made a good faith effort to determine and file and pay his proper tax liability if he exercised ordinary business care and prudence in so doing. A determination of whether taxpayer exercised ordinary business care and prudence is dependent upon

the clarity of the law or its interpretation and the taxpayer's experience knowledge, and education.”

86 Ill. Admin. Code Sec. 700.400(c)

Despite the Department's contentions, the record reveals that the taxpayer made a good faith effort to determine the tax due, timely file the IL-501s and IL-941s and remit the taxes due. Not only did the taxpayer have internal procedures to ensure timely payments of withholding tax, it also followed procedures to ensure that the IL-941s were timely filed. The IL-941s at issue were prepared by “BHC's” Senior Payroll Tax accountant, Mr. “Doe”. Mr. “Doe” is no longer employed by the taxpayer, therefore, “BHC's” Tax Manager, Mr. “Richard Roe”, provided an affidavit wherein he stated that Mr. “Doe” was responsible for preparing, signing and mailing “BHC's” Form IL-941 tax returns during the period at issue. “Doe” was also responsible for preparing and filing all federal payroll tax returns and state unemployment returns for the hotels in the “BHC” chain, making the related tax deposits and payments and was authorized to sign “BHC's” federal quarterly returns (Form 941) and its IL-941 returns. “Roe” Affidavit ¶ 20. Mr. “Doe” worked in “BHC's” payroll department for approximately 15 years and had a good reputation. “Roe” Affidavit ¶ 23. With the possible exception of the IL-941 returns at issue, no errors have been found in “Doe's” work. “Roe” ¶ 24.

Further, the record reflects that “Doe” followed specific procedures to ensure “BHC's” IL-941s were filed timely. As part of his normal business practice, “Doe” prepared a checklist that listed the payroll tax deadlines in each state for each quarter including the IL-501 and IL-941 tax returns. “Roe” Affidavit ¶ 25. “Doe” or his assistant wrote the date that each item was mailed on the checklist. “Roe” or “James Dandy”, “BHC's” Assistant Vice President, reviewed that checklist at the end of each

quarter and confirmed with “Doe” that all returns were timely filed. “Roe” Affidavit ¶ 26. “Doe” and his assistant were instructed to inform their supervisors if they had any problems or difficulties in timely filing the IL-941 returns, and “Roe” and “Dandy” periodically checked with “Doe” during the quarter to confirm that they were current with their filing and payment deadlines. “Roe” Affidavit ¶ 26. Despite a through search by “Roe”, “Doe’s” checklists for the four quarters at issue were not located since it was “Doe’s” practice to throw the checklists out after approximately three years (the typical statute of limitations). “Roe” ¶ 27. Furthermore, taxpayer maintains that “BHC” has been in complete compliance with the requirements of Article 7 of the IITA before and after the quarters in issue, including the period January 1, 1992 through September 30, 1994 and the record does not reflect otherwise.

One ancillary issue also needs to be addressed. Taxpayer disputes the total amount of Illinois withholding tax for the fourth quarter as stated on the NOD. The taxpayer asserts that its tax underpayment for the fourth quarter of 1994 is \$6,662.66 (209,015.56 - 202,352.90). Taxpayer contends that it does not know the source of the \$209,015.56, however, the Department’s Response to Taxpayer’s First Set of Interrogatories No. 4 clearly stated that the amount was taken from the IL-W-3, “Illinois Annual Withholding Income Tax Return,” that the taxpayer filed for 1994. Although the taxpayer attached copies of the IL-941s that it prepared subsequent to the issuance of the NOD, in its supporting memorandum the taxpayer did not contest that it had, in fact, filed this IL-W-3. Merely attaching IL-941s that were admittedly prepared subsequent to the issuance of the NOD does not rebut the *prima facie* correctness of the Department’s

determination, therefore, the amount of the tax withheld for the fourth quarter as stated on the NOD should stand. 35 ILCS 5/904(a).

The procedures as outlined above demonstrate that the taxpayer exercised ordinary business care and prudence in filing its Illinois withholding tax returns. Accordingly, I find that the taxpayer made a good faith effort to timely file its IL-941 tax returns for the quarters at issue and is, therefore, entitled to an abatement of all late-filing penalties due to reasonable cause. As a result of such a determination, the remaining issues need not be addressed.

Date: March 1, 2000

Administrative Law Judge